Missouri Securities Division

Secretary of State Robin Carnahan

Protecting Seniors and Their Life Savings: Policies and Practices of Missouri's Investment Firms

In early 2010, Secretary of State Robin Carnahan's Securities Division launched a series of statewide audits to examine the practices and safeguards put in place by Missouri-registered broker-dealer and investment adviser firms to protect their senior clients and address the unique challenges of those customers.

December 2010

EXECUTIVE SUMMARY

Protecting senior citizen investors is a major focus of the Missouri Securities Division. As the senior population grows, older investors have increasingly been the victims of financial abuse and fraud. Accordingly, they need greater protections. The Missouri Securities Division identified both assisting investors with diminished capacity and overall senior investor education as crucial issues in the fight against senior investor fraud. Over the past six years*,* Secretary of State Robin Carnahan and the Division have launched and expanded senior outreach and awareness campaigns, supported important changes in laws and rules that will increase senior protection, and conducted innovative regulatory activities and programs aimed at protecting Missouri's senior investors.

Missouri Secretary of State Robin Carnahan unveils the 2010 top threats and tips for Missouri investors at a senior center in Hannibal.

With complaints and inquiries from senior citizen investors concerning financial services and investment fraud increasing, the Missouri Securities Division, which is housed in Secretary Carnahan's office, engaged in efforts to determine how to best increase protection for those older investors. In early 2010, the Division launched a Senior Investor Protection Audit Sweep ("Sweep") to examine the practices and safeguards put in place by Missouri-registered broker-dealer and investment adviser firms to protect their senior clients and address the unique challenges of those customers. This six month, 30-firm examination and inspection effort,

executed by the Division's Audit Unit, gauged how brokerage and investment adviser firms across the state protect their senior clients and comply with applicable laws and regulations.

The Sweep revealed that many Missouri-registered broker-dealers and investment adviser firms have not taken specific steps to identify and respond to common concerns or issues when working with seniors. Overall, there is a need for a more formal, structured, and objective approach to senior issues. Additionally, the Division's auditors discovered that Missouri investment adviser firms almost universally lack specific policies or evidence of a thoroughly considered approach for handling senior investor protection and compliance.

There is a need for a more formal, structured, and objective approach to senior issues.

The 30 examinations did produce numerous instances that indicate some in the financial services community, particularly broker-dealers, have invested time and resources into considering and, in some cases, implementing a specific senior investor strategy. While not all broker-dealer and investment adviser firms are alike, and practices that work for one firm might not necessarily benefit another, there are certain issues and challenges that firms commonly encounter when working with seniors.

The Division has identified a number of practices that firms should consider to better serve seniors, such as:

(1) adopting a definition of "elderly" person that is practical and client specific;

(2) identifying certain investments (e.g., variable annuities) that trigger a heightened review by management when sold to a senior investor;

(3) prohibiting agents from targeting seniors in their advertising; and

(4) ensuring that account information for seniors is regularly reviewed and updated – in person.

The Division has also developed next steps the Division itself may take as a result of the Sweep's findings, such as:

(1) adding the Sweep module questions to all routine audits;

(2) comparing best practices identified by the Sweep to findings by the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA), and incorporating those findings into examination and outreach programs; and

(3) working with consumer groups regarding issues surrounding the credentialing of financial or securities professionals.

Table of Contents

Introduction **1**
Reasons for the Sweep **2**
Background on senior investor vulnerability 3
Recent steps to improve senior investor protection 5
Industry mechanisms for protecting senior clients 9
Sweep Objectives **10**
Sweep Methodology **11**
Sweep Findings **13**
Senior definitions 15
Compliance/Supervisory practices 16
Marketing/Advertising 17
Account opening practices/updates 19
Education/Training on senior issues – cognitive decline 20
Best Practices **22**
Senior definitions 22
Compliance/Supervisory practices 23
Marketing/Advertising 24
Account opening practices/updates 25
Education/Training on senior issues – cognitive decline 27
Next Steps **28**

INTRODUCTION

With complaints and inquiries from senior citizen investors concerning financial services and investment fraud increasing, the Missouri Securities Division, a division in the Office of Missouri Secretary of State Robin Carnahan,[1] took steps to determine how to best increase protection for those investors. In early 2010, Secretary Carnahan launched the Senior Investor Protection Audit Sweep ("Sweep"), a six-month, 30-firm examination and inspection effort executed by the Missouri Securities Division's Audit Unit[2] designed to gauge how brokerage and investment adviser firms protect their senior clients and comply with applicable laws and regulations.

The Sweep revealed that many brokers and investment advisers in Missouri do recognize that senior client issues need special attention. While some have implemented specific practices and policies to address those issues, much improvement can be made. The Sweep demonstrated that Missouri firms need to carefully consider enhancements to their compliance and supervisory approaches concerning senior clients. The firms also should take into account a variety of identified industry best practices to avoid complaints and regulatory actions stemming from senior investors exposed to unsuitable recommendations, inappropriate marketing efforts or securities fraud.

Firms need to carefully consider enhancements to their compliance and supervisory approaches concerning senior clients

[1] Robin Carnahan was sworn in as Missouri's 38th Secretary of State in January 2005. She won re-election in 2008.
[2] The Audit Unit is a part of the Registration Section of the Missouri Securities Division and includes two attorneys and four full-time compliance auditors. At the time of these audits, the eight auditors, special investigators and attorneys who perform the audit and examination functions in the Securities Division had 56 years of combined regulatory experience and an additional 26 years of experience in the industry.

As a result of the Sweep, the Missouri Securities Division will expand its routine examination modules to include the special Sweep audit components, consider an awareness and outreach campaign to highlight senior client issues for both firms and investors, and seek methods for enhancing its overall senior investor protection efforts.

REASONS FOR THE SWEEP

In 2009, the Missouri Securities Division, in furtherance of its long-standing priority of protecting senior investors, determined to examine the practices and safeguards employed by Missouri-registered broker-dealer and investment adviser firms to protect their senior clients. This undertaking was launched due to several factors, including an aging population of investors, an increasingly high level of senior complaints to the Division, and the increase in reports of financial fraud against seniors. To examine the safeguards in place at Missouri-registered firms, the Securities Division conducted targeted audits of 24 broker-dealer firms and six investment adviser firms. The audits involved evaluating the firms' policies, procedures, and client interactions to gauge how issues that arise when serving senior clients are addressed.

The audits involved evaluating the firms' policies, procedures, and client interactions to gauge how issues that arise when serving senior clients are addressed

Background on Senior Investor Vulnerability

The first baby boomers (individuals born between 1946 and 1964) will turn 65 in 2011.[3] This represents a major expansion of senior investors in the United States. According to U.S. Census Bureau projections, there will be a substantial increase in the number of people age 65 and older between 2010 and 2030.[4] By 2030, this segment of the population will grow from 35 million to 72 million and represent nearly 20 percent of the total U.S. population.[5]

Statistics show that baby boomers today control more than $13 trillion in household investable assets, or over 50% of the total U.S. household investable assets.[6] Given that these individuals will need and seek financial advice and guidance as they near and enter retirement, protecting them against financial abuse and investment fraud will prove a most critical duty for state securities regulators.

Indeed, the growth in the senior population has already led to increased financial fraud against these individuals: Studies show that more than 7.3 million seniors (one out of every five citizens over the age of 65) have been victims of financial fraud.[7] Furthermore, for every one case of elder abuse, neglect, exploitation, or self-neglect reported to authorities overall, it is estimated

---

[3] *See* Theodore J. Sawicki, et. al., "When the Baby Boom Era Becomes the Retirement Explosion: A Securities Compliance Professional's Guide to Protecting Her Firm and Senior Customers," (September 2007).

[4] He, Wan, Manisha Sengupta, Victoria A. Velkoff, and Kimberly A DeBarros, U.S. Census Bureau, Current Population Reports, p20, 65+ in the United States: 2005, U.S. Government Printing Office, Washington, DC, (2005), *available at* http://www.census.gov/prod/2006pubs/p23-209.pdf

[5] *Id.*

[6] "Retirement of boomers will create market for advisers" by Sue Asci, InvestmentNews, November 5, 2007, *available at* http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071105/FREE/711050311/-1/INIssueAlert.

[7] "*NASAA Leads Fight Against Elder Financial Abuse*," (June 15, 2010), *available at* http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/12775.cfm.

that as many as five go unreported.[8] This evidence has made it abundantly clear that senior investors need greater protection.

The Missouri Securities Division has also identified investor diminished capacity and senior investor education as crucial issues in the fight against senior investor fraud. Persons with mild diminished capacity can perform most daily functions, but may become confused when managing their finances. This, in turn, makes those individuals more susceptible to fraud. According to a 2008 Duke University study, about 35 percent of the 25 million people in the United States who are 71 or older either have mild cognitive impairment or dementia.[9] Another study indicates that about half the population between ages eighty and ninety has a medical diagnosis of substantial cognitive impairment.[10]

An investor's diminished capacity may make it difficult, if not impossible, for a client to understand a transaction or for a financial professional to make a suitable recommendation. Important decisions concerning complex financial products require "fluid intelligence," logic and problem solving in novel

An investor's diminished capacity may make it difficult, if not impossible ... for a financial professional to make a suitable recommendation

[8] National Elder Abuse Incidence Study 1998, Washington DC, National Center on Elder Abuse at American Public Human Services Association, *available at* http://www.ncea.aoa.gov/ncearoot/Main_Site/pdf/publication/FinalStatistics050331.pdf.
[9] "Enlisting Doctors to Screen for Financial Fraud", Kelly Greene, The Wall Street Journal, July 10, 2010 *available at* http://online.wsj.com/article/SB10001424052748704178004575351263406334440.html?KEYWORDS=Enlisting+Doctors+to+Screen+for+Financial+Fraud
[10] Sumit Agarwal, et al., "The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulations," Brookings Papers for Economic Activity, p. 1 (Fall 2009)

situations—but research indicates that the fluid intelligence of the average individual falls by about one percentile with each year from age 20 to age 80.[11] This makes comprehension of difficult concepts and complex products challenging for senior individuals. A suitable recommendation is based on a client's financial situation and needs, and a financial professional must obtain this essential information and make sure the client comprehends an investment's features and risks.[12] Under Missouri securities regulations, it is a dishonest or unethical practice for an adviser-broker to recommend to a client the purchase, sale, or exchange of any investment when the agent does not have reasonable grounds to believe that the recommendation is suitable for the client.[13] Should a senior client be unable to provide the personal information necessary for the determination of a suitable recommendation, or lack the capability to understand the transaction due to diminished capacity, a financial professional may not be able to make a suitable recommendation. If the financial professional's firm does not have a policy regarding these difficult issues affecting seniors, the financial professional may be left in a difficult situation, and the senior investor might not have the protections he or she needs.

Recent Steps to Improve Senior Investor Protection

Regulators at both the state and federal levels have recognized these issues and have already taken steps to protect senior investors. In 2008, the Securities and Exchange Commission (SEC), the North American Securities Administrators Association (NASAA), and the Financial Industry

---

[11] Sumit Agarwal, et al., "The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulations," Brookings Papers for Economic Activity, p. 2 (Fall 2009)
[12] MO 15 CSR 30-51.170(1)(E); MO 15 CSR 30-51.172(1)(A).
[13] *Id.*

Regulatory Authority (FINRA) jointly produced reports addressing both the protection of senior investors (focusing on compliance, supervisory, and other practices used by financial services firms) [14] and the ubiquitous free lunch investment seminars that target seniors and are held in communities across the nation.[15] Prior to that, in July 2006 the SEC held its first "Seniors Summit" to examine how regulators and others could better coordinate efforts to protect seniors from investment fraud.[16] And FINRA has urged broker-dealers to review and enhance their practices and policies regarding senior investors through Regulatory Notice 07-43.[17] Additionally, NASAA has recently joined forces with physicians and adult protective services to educate medical professionals and other caregivers on how to identify seniors who may be vulnerable to financial scams and abuse.[18]

Secretary of State Carnahan and the Missouri Securities Division have been leaders in the effort to increase and improve senior investor protections. Over the past six years, Secretary Carnahan and the Division have launched and expanded senior outreach and awareness

---

[14] See "*Protecting Senior Investors: Compliance, Supervisory and Other Practices used by Financial Services Firms in Serving Senior Investors*" (Joint Report of SEC Staff, NASAA, and FINRA, September 2008) *available at* http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf; NASAA, the SEC and FINRA updated the senior practices report in 2010; available at http://www.nasaa.org/content/Files/SENIOR3ReportFINAL81210.pdf.

[15] "*Protecting Senior Investors: Report of Examinations of Securities Firms Providing 'Free Lunch' Sales Seminars"* (Joint Report of SEC Staff, NASAA, and FINRA, September 2007) *available at* http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

[16] See http://www.sec.gov/news/press/2006/2006-109.htm.

[17] "*Senior Investors: FINRA Reminds Firms of Their Obligations Relating to Senior Investors*," (Regulatory Notice 07-43, September 10, 2007) *available at* http://www.finra.org/Industry/Regulation/Notices/2007/P036815. This regulatory notice focuses on the suitability of recommendations to senior investors and communications aimed at these senior investors, such as the use of professional designations (i.e. "certified senior adviser" or "senior specialist") and aggressive or misleading sales tactics.

[18] *Supra* note 4. NASAA's stated goal is to educate medical professionals to identify warning signs that a senior patient may be a fraud victim or need help with his or her finances. Ideally, the medical professional will then report the possible fraud to securities regulators and abuse to local adult protective services.

campaigns, championed important statutes and rules that will increase senior protection, and conducted innovative regulatory activities and programs aimed at protecting senior investors.

Secretary Carnahan, concerned about individuals that claim to have specialized knowledge of senior investors' needs but had no such expertise, began to implement changes to address these concerns in 2006. She named these so called "Senior Specialists" as a top threat for Missouri investors in 2006, 2007, and 2008.

After assisting in national efforts to craft regulatory solutions to the misuse of senior-specific designations, Secretary Carnahan and her staff amended Missouri state regulations to prohibit such misuse. The regulation that took effect in 2009 made it clear that using a senior specific certification or designation to mislead a senior investor is a dishonest or unethical practice under Missouri securities laws.[19]

In addition to the threat posed by misleading senior designations, Secretary Carnahan has long identified unsuitable recommendations and sales practices concerning variable and equity-indexed annuities as a top threat to investors, especially seniors. Equity-indexed annuities, the primary product pitched at free lunch investment seminars, which target seniors across Missouri, are often unsuitable for senior investors because of long lock-up periods, high surrender fees, high commissions, and a high level of complexity. Variable annuities are also extremely complex investments. Although these types of annuities may be suitable for many

[19] MO 15 CSR 30-51.172(2).

investors, they pose a particular threat for senior investors who may need access to their savings to pay unexpected expenses associated with aging.

The free lunch investment seminars where equity-indexed annuities are the featured product often involve aggressive or misleading sales tactics aimed at senior investors. According to a study by federal and state securities regulators, 78 percent of seniors have received at least one free lunch invitation over the past three years.[20] Recognizing the potential for investor harm at these events, Secretary Carnahan named free lunch seminars as a top threat to Missouri investors in both 2006 and 2007. Beginning in late 2006, the Missouri Securities Division conducted a year-long under-cover investigation of free lunch investment seminars that culminated in a comprehensive report.[21] The investigation revealed that this common marketing tool, promoted as an educational service, is instead almost always a sales technique employed by salesmen with questionable backgrounds that target seniors and promote suspect products.

The Missouri Securities Division continues to receive complaints and conduct investigations concerning free lunch seminars. During these investigations, the Securities Division reviews the background of the salespersons who present free lunch seminars, the professional designations utilized, the marketing materials used, the claims made at the seminars, and the recommendations offered to seniors during subsequent private consultations.

---

[20] Jane Bryant Quinn, "The Worst Deal in America: 'Free Lunch' Seminars for Seniors," CBS MoneyWatch (July 7, 2010).

[21] "*2007 'Free Lunch' Investment Seminars: A Report by the Missouri Securities Division's Senior Investor Protection Unit*" (Winter 2008).

In 2009, Secretary Carnahan and the Missouri Securities Division won another important victory for senior investor protection with the passage of the Senior Investor Protection Act. The new law significantly increased the penalties for financial fraud and securities violations committed against seniors and disabled individuals, while also allowing the Commissioner of Securities to order restitution for aggrieved investors. This law, passed with bipartisan support in the Missouri Legislature, is among the most effective in the nation.

With these investor protection tools and programs in place, the Missouri Securities Division has continued to monitor the investment services industry and to seek the optimal methods for improving protections. This commitment to improving senior investor protection led to the Sweep.

Missouri firms in the financial services industry should have clear, practical and thorough procedures for handling senior clients and their particular needs

Industry Mechanisms for Protecting Senior Clients

Because senior financial abuse is widespread and regulatory efforts alone will not prevent harm to senior investors, registered broker-dealers and investment-adviser firms should recognize the risk of financial harm to seniors and work to avoid and stop that abuse. Missouri firms in the financial services industry should have clear, practical and thorough procedures for handling senior clients and their particular needs, including diminished capacity.

During the Sweep, the Missouri Securities Division evaluated and examined the extent to which registered broker-dealers and investment advisers have specialized policies, procedures or consistent practices in place concerning senior investor issues, including items regarding:

(1) the potential involvement of a family member or trusted professional in a senior investment related decision;

(2) complaint procedures and prohibitions regarding senior client accounts;

(3) detection of elder abuse or financial exploitation by any firm representative;

(4) advertising or seminars that target senior clients;

(5) obtaining personal and financial information from senior clients; and

(6) ensuring that account information for senior clients is current.

SWEEP OBJECTIVES

The Missouri Securities Division had four objectives for the Sweep:

(1) gauge broker-dealer and investment adviser firms' preparedness and recognition of special challenges for some senior clients;

(2) identify key areas of concern, common deficiencies, and problematic practices related to senior clients;

(3) identify best practices used by broker-dealers and investment advisers in dealing with senior investors; and

(4) identify and determine methods and vehicles for delivering important education on these issues to both firms and investors.

SWEEP METHODOLOGY

From February to July 2010, the Missouri Securities Division examined 30 Missouri-registered broker-dealers and investment adviser firms in regions across the state. The Division focused on large broker-dealers whose home offices are located in Missouri, along with those that have branches within the state. The investment adviser firms included in the Sweep were those examined as part of the Division's regular compliance exam cycle.[22]

Prior to conducting the Sweep examinations, the Audit Unit prepared a special examination kit modeled on the customary NASAA examination modules and enhanced with senior investor issues and items. During each examination, auditors interviewed a compliance officer or other supervising officer, and asked senior client-specific questions such as:

- Does the firm provide specialized training for its registered representatives that focuses on identification of clients with cognitive problems?
- Does the firm send out compliance bulletins or any other internal communication on issues related to cognitive decline?
- Does the firm impose any types of limitations on its registered representatives when there are indications that a senior client may be demonstrating signs of cognitive decline?
- Does the firm have specific policies and procedures in place to detect financial exploitation of clients who may exhibit cognitive impairment?

[22] The Missouri-registered investment advisers included in the Sweep were sole proprietorships or small offices with two or three representatives.

- Does the firm have a policy in place that requires the registered representative to report instances of suspected cognitive decline of a client to an outside agency that specifically deals with these types of issues?
- Does the firm prohibit registered representatives from soliciting and selling investments in a client's account when there are indications of cognitive decline with a client?
- Does the firm identify certain investments that warrant heightened review by management or compliance when sold to senior clients?
- Does the firm have special policies and procedures in place to detect elder abuse or financial exploitation by registered representatives?
- Does the firm have policies and procedures in place that require special management involvement when opening new accounts for senior clients?
- Does the firm have policies and procedures in place that require management review and approval when investment objectives are changed on a senior client's account?
- Does the firm have registered representatives that possess senior-specific professional designations?

During the examinations, auditors gathered information including:

(1) the firm's compliance manual;

(2) written supervisory procedures;

(3) any specialized policies and procedures regarding seniors;

(4) samples of exception reports specific to senior clients;

(5) compliance bulletins or any other internal communication related to senior clients; and

(6) documentation of any training relating to seniors that is provided to the firm's agents, supervisory personnel, and other employees.

SWEEP FINDINGS

The Sweep revealed that many Missouri-registered broker-dealers and investment adviser firms have not taken specific steps to identify and respond to common concerns or issues when working with seniors. The Sweep demonstrated that many broker-dealer firms do not have formalized policies in place to allow for greater protection of senior clients, and that investment advisers rely on *ad hoc* or organic processes or interactions to address commonplace senior investor challenges. Overall, the Division finds a need for a more formal, structured, and objective approach to senior issues.

In the initial stages of the examination, 75 percent of audited broker-dealers reported that their firms did have policies and procedures regarding senior clients in their compliance and supervisory manuals; further examination, however, revealed that most of these policies consisted solely of suggested "best practices" rather than a required or mandated set of procedures. These "best practices" suggestions were rarely in the form of a formal policy of which failure to follow would lead to discipline. The lack of a formal policy leaves broker-dealer

agents and personnel with little guidance other than to generally consider unspecified senior investor needs and with nowhere to turn for precise steps when dealing with senior clients.

The Missouri Securities Division's auditors discovered that Missouri investment adviser firms almost universally lack specific policies or evidence of a thoroughly considered approach for handling senior investor protection and compliance. There is an alarming lack of formal, written policies or documented guidelines or practices in this area. Instead, investment advisers appear to rely on personal familiarity with their clients and the idea that because of the relatively small size of their adviser operation or limited client roster, they do not need to document, record or otherwise preserve a standardized approach to handling senior investor problems.

There is an alarming lack of formal, written policies or document guidelines or practices

While no audited investment adviser produced a written policy concerning senior clients or how to handle their unique issues, 65 percent of the audited firms stated that at the time of account opening, the firm does inquire as to whether a senior client has a durable power of attorney. Further, the same percentage also reported they require a senior investor to open their new account in person. Most of these firms also obtained the name and contact information for an emergency contact or alternative contact for each senior client. But no firm produced documentation indicating that these reported practices are always followed or are standard, expected procedures. No investment adviser produced evidence of information or

internal guidance that would inform senior marketing practices or senior client account maintenance. The audit of investment advisers also indicates that investment advisers do not seek or secure training on senior investor issues.

The 30 examinations did produce numerous instances which indicate that some in the financial services community, particularly broker-dealers, have invested time and resources into considering and, in a few cases, implementing a specific senior investor strategy. The information gathered during the Sweep can be categorized into five areas:

(1) senior definitions;

(2) compliance/supervisory practices;

(3) marketing/advertising practices;

(4) account opening practices/updates; and

(5) firm education/training on senior client issues and cognitive decline.

Senior Definitions

Many firms do not categorize older investors as "senior" by attaching a specific age. In determining whether a client is a senior, firms often consider numerous factors such as: (a) whether the investor is retired or is nearing retirement; (b) the life stage of the investor; or (c) whether the product being marketed, considered or sold has specific suitability requirements regarding the age of the investor.

Examples of senior definitions found in firm compliance or operations manuals:

- "Senior clients are generally defined as an owner or co-owner age 65 or over."
- "Field consultants should document each client's capacity to understand the nature of the product, its costs and unique characteristics, regardless of the person's numerical age."
- "Senior clients depend on multiple variables including: (a) state of residence; and (b) life state/investment cycle."

Compliance/Supervisory Practices

Many firms have some type of compliance or supervisory practices in place regarding recommendations to senior investors. Over 50 percent of the broker-dealers examined in the Sweep utilize special exception reports for issues specific to senior clients.

Approximately 55 percent of the firms identify certain investments that warrant heightened review by management or compliance when they are sold to seniors. The products warranting heightened scrutiny are often variable annuity products.

A mere 33 percent of examined firms demonstrated specific policies and procedures for detecting elder abuse or financial exploitation by registered agents or representatives.

Examples of compliance/supervisory practices or directions found in firm manuals:

- "Spend additional time with senior investors explaining the features, benefits, costs, and risks of the product to ensure complete understanding of investment and encourage clients to involve a trusted individual to increase understanding. Document these meetings, send follow-up letters and retain in client file."
- "Increase the frequency of contact with senior investors and remain informed regarding their personal and financial situation. Document conversations with these clients in case they have problems with lack of recall or to help resolve misunderstanding."
- "The firm's Chief Compliance Officer will ensure that annual review is taken of all senior accounts. This review will focus on transactions involving products that have withdrawal penalties or otherwise lack liquidity."
- "Red flag exception reports include age max products, registered agents use of unapproved senior title designations, and overall product recommendation is unsuitable."

Marketing/Advertising

The majority of firms do not distinguish between general clients and senior clients in their advertising, and only 30 percent of the examined firms indicated that they have special policies and procedures in place regarding advertising and seminars that target senior clients. As noted above, free lunch investment seminars are a marketing technique which has recently garnered much regulatory attention nationwide. The Sweep revealed that 73 percent of the examined firms did not have any policies in place which prohibited, restricted or otherwise addressed free lunch investment seminars that target seniors. Six firms specifically acknowledged that they had

recently allowed agents to conduct free lunch investment seminars, workshops or similar programs targeting senior investors.

Only four of the 30 examined firms have policies in place that restrict the location of free lunch investment seminars; this indicates that many such seminars can be held at assisted living facilities, nursing homes or other similar settings. Over half of the examined firms acknowledged expressly allowing agents to solicit and sell investment products in such settings.

In addition to the free lunch investment seminars, state securities regulators have been particularly attuned to marketing issues arising from the misuse of senior-specific designations. Forty percent of the examined firms indicated that they restrict the use of professional designations on business cards or marketing materials. Only five examined firms specifically reported they currently employ agents or representatives who possess and use senior-specific professional designations. Of the firms that do allow the use of such designations, most provide a list of firm-approved designations and limit use to those on that list.

Examples of marketing/advertising policies found in firm manuals:

- "All materials used for free lunch seminars must receive prior written approval."
- "Any firm agents found to be using high pressure tactics (senior designations, ghostwritten materials, free lunch seminars) with any senior clients will be subject to disciplinary action."
- "Financial agents may not use professional designations that suggest an expertise in financial services for seniors."

Account Opening Practices/Updates

Broker-dealers are required to obtain information about a client to ensure that any firm recommendations are suitable for the client, and that the client's account is managed consistently with the client's investment objectives.[23] It is standard in the industry for much of this effort to be undertaken at the time a new account is opened, and the opening of a new account also offers a good opportunity to specifically explore issues of particular concern to senior investors.

Ninety percent of examined broker-dealers did not have specialized procedures for obtaining new account information from senior clients

The Sweep revealed that 90 percent of examined broker-dealers did not have specialized procedures for obtaining new account information from senior clients. These firms make no distinction when opening a senior or non-senior account and gather client information, regardless of age, by following general policies. While many of the firms do not distinguish between a senior or non-senior client when gathering new account information, 16 percent of firms require that new accounts for senior clients be opened in person.

Some firms suggest agents use the account opening process to inquire whether or not the senior client has a durable power of attorney and to gather emergency or alternative contact information; while this suggestion is made by a few firms, none implements disciplinary

[23] MO 15 CSR 30-51.170(1)(E) & (BB); MO 15 CSR 30-51.172(1)(A).

measures for an agent's failure to follow the firm's suggestion. The majority of examined firms do not have specialized procedures for senior client account maintenance and reviews. In fact, 75 percent of the examined firms update the personal and financial information on senior accounts according to general policies for maintaining up-to-date client information.

Examples of account opening practices/updates found in firm manuals:

- "Ask clients if they have executed a durable power of attorney."
- "Ask, either at account opening or at a later time, whether the client would like to designate a secondary or emergency contact for the account whom the firm could contact if it could not contact the client or had concerns about the client's whereabouts or health."
- "Asking the client if he or she would like to invite a friend or family member to accompany the client to appointments at the firm."

Education/Training on Senior Issues – Cognitive Decline

Brokers and advisers are often uniquely positioned to help clients learn how to avoid fraudulent solicitations and scams, and identify problems early – including cognitive decline. In recognition of this opportunity to help clients, 75 percent of the broker-dealers examined issue internal compliance bulletins or another type of internal communication on issues related to senior clients. Eighty-five percent of the examined firms provide specialized training related to senior client issues for their registered representatives. In the majority of firms where training (other than bulletins or electronic mail) is provided, the training is mandatory. However, only 35 percent of the examined firms provide specialized training focusing on cognitive problems.

Broker-dealer firms rely on e-mails, annual training, and their web sites to offer senior information to their agents. The materials disseminated through these channels demonstrate firms' attempts to ensure that firm representatives are notified of any senior training or a change in any compliance practice.

Examples of education/training found in firm materials:

- "Diminished Capacity (Possible Warning Signs): (1) Asks the same questions repeatedly; (2) Not as engaging/fails to fully participate; (3) Disoriented/Confused; (4) Home is in disarray; (5) Failing to care for pets; (6) Hygiene concerns; (7) Paranoia; (8) Irrational transaction requests."
- "Problematic References: Mutual fund, exchange traded fund, variable annuity, 529 plan, REIT (Any discussion of these products requires FINRA filing and substantial risk disclosure. The only exception is when the products are referenced in a "laundry list" of services and investments offered)."
- "Prevention of fraud and questionable business practices are issues that are being addressed by not only FINRA, but by the states and firms as well. Ultimately, the responsibility lies with the registered rep to do what's right for his client. To prevent ethics violations the rep must act as a fiduciary, make suitable recommendations, advise the client on the status of the investment and always put the client's needs ahead of his own."

BEST PRACTICES

While not all broker-dealer or investment adviser firms are alike, and practices that may work for one firm may not necessarily benefit another, there are certain issues and challenges that firms commonly encounter when working with seniors. The Sweep identified a variety of practices or approaches in place at Missouri firms that seem well-designed to protect senior investors and prevent complaints, losses or problems. The Missouri Securities Division has further identified a number of practices that firms should consider adopting to better serve seniors.

Senior Definitions

Missouri regulations define an "elderly person" as a person 60 years of age or older.[24] Sixty is also within five years of traditional retirement and the key age for some tax deferred benefits. Reliance on Missouri law to generally divide between senior clients and others may be a good first step in establishing a strategy for handling senior client issues. However, firms that adopt a more practical, client-specific approach to determining when unique senior issues have arisen or may soon arise, including consideration of a client's life stage, investment objectives, net worth, health issues, family situation and investment history, will be better situated to avoid senior-related business and regulatory problems.

[24] MO 15 CSR 30-51.172(2)(D)2.

Compliance/Supervisory Practices

Specialized supervisory review policies for senior client accounts can be a key to preventing abuse and avoiding mistakes or confusion. Some firms use age as the primary factor in determining when to trigger their supervisory reviews of senior accounts. Other firms require special supervisory review of all accounts that include investment objectives more aggressive than “income” for investors over a certain age. Both of these approaches seem well-designed to prevent unsuitable recommendations.

Firms that identify certain investments, such as variable and equity-indexed annuities, as warranting heightened review by management or compliance staff when they are sold to senior clients may be able to avoid customer complaints (to the firm or to regulators). Firms that use exception reports to isolate activities and accounts for additional review are also better equipped to handle senior-specific matters. The Sweep also revealed that maintaining trade blotters that contain senior clients account information alongside relevant transactions provides a simple and efficient method for supervision and surveillance.

Firms that can identify certain investments … as warranting heightened review by management or compliance staff when they are sold to senior clients may be able to avoid customer complaints

Advertising/Marketing

All Missouri firms should consider heightening their review and approval process for the use of marketing and sales materials and sales seminars with respect to seniors. Such policies might include:

(1) prohibiting representatives from specifically or solely targeting senior clients and potential senior clients;

(2) prohibiting the soliciting and selling of investments to residents in assisted living facilities, nursing homes, or other senior living settings;

(3) providing a library of pre-approved materials for senior clients that are reviewed and approved by supervisory and compliance personnel; and

(4) supervisory and compliance personnel performing a minimum number of unannounced compliance visits to investment seminars on a periodic basis.

Firms that have special policies and procedures in place regarding advertising and marketing that target senior clients are less likely to encounter regulatory issues. In most recent years, well more than half of the complaints received by the Missouri Securities Division have been from or related to senior investors, and traditionally, complaints to state regulators often involve sales practices or marketing techniques. When a firm avoids suspect or questionable advertising and marketing that targets seniors, it will also avoid related complaints.

For example, firms run less risk of running afoul of Missouri laws prohibiting misuse of senior specific designations when they do not allow those designations to be used.

Additionally, not allowing seminars that target senior investors prevents the misuse of that type of marketing, which is also a common subject of investor complaints to regulators.

Account Opening Practices/Updates

A specific policy that ensures account information for senior clients is maintained, regularly reviewed, and updated is a solid approach to avoiding unsuitable recommendations. This information is vital because as investors age, their investment time horizons, and objectives, risk tolerance, family's needs and tax status may change. Liquidity becomes a higher priority, and products that were once a sound investment may no longer be suitable if money is locked up in complicated products where liquidation is possible only after a substantial penalty is paid. These changes in investment needs and goals can be recognized in a timely manner through regular account maintenance and updating.

The account opening process is an opportunity to pose questions that broaden and expand the conversation with seniors regarding their goals, risks, and investment concerns. Some firms require new accounts to be opened in person for senior customers as a method for encouraging this broadened conversation, and that is a best practice that all Missouri firms should consider. Special involvement by firm management or compliance experts when opening new accounts for senior clients may also be beneficial.

Firms should consider implementing account opening procedures that direct registered agents to:

(1) have more frequent communication with senior clients than with non-senior clients;

(2) document their conversations with senior clients; and

(3) send follow-up written confirmation to senior clients with regard to investment decisions.

A firm may also consider launching a special website specifically dedicated to senior clients containing any firm information that is relevant to this client group, as well as providing written materials (that can be understood by a layperson at the first reading) that senior clients may take home and study before making any investment decisions.

Because senior investors' life stages or circumstances may dramatically and quickly change, conducting periodic supervisory interviews with registered representatives to discuss the portfolios of senior clients is an important compliance safeguard. Firms should also conduct frequent updates of account information for seniors. Firms might also benefit from having policies and procedures in place that require management review and approval when a senior client's investment objectives change.

Education/Training on Senior Issues – Cognitive Decline

While most broker-dealers reported offering some training related to senior client issues for agents, investment advisers did not. And although many broker-dealers did report that they provide senior training, the firms rarely had specialized training that focused on the identification of clients with cognitive problems. Senior issues training should be mandatory and should specifically address cognitive problems, such as the ability to identify changes in a client's hearing, sight, comprehension, retention of information, signs of dementia, and the capacity to make investment-related decisions.

Firms should explore policies and practices that will help agents and representatives detect senior abuse or financial exploitation. Firms would also be well-served to have a referral process to an outside agency, such as regulators (e.g., the Department of Health and Human Services) or consumer-oriented groups (e.g., the Consumer Federation of America or the AARP). Firms should also consider a policy that requires firm representatives to detect and report financial exploitation of clients who exhibit cognitive impairment.

NEXT STEPS

The Sweep and best practices outlined in this report lay the groundwork for improving senior investor protection in Missouri. The Missouri Securities Division will continue to examine Missouri-registered broker-dealers and investment adviser firms' policies and procedures regarding senior clients and any potential senior issues, including cognitive decline. Furthermore, the Missouri Securities Division may take the following actions:

- Add the modules, battery of questions, and other tools developed for and employed during the Sweep to the Missouri Securities Division's exams during all future routine compliance exams.

- Compare the best practices for firms serving senior investors highlighted in the joint NASAA, SEC and FINRA reports from 2008 and 2010 to the findings of this report, and determine whether and how to incorporate the best combined components into future examination and industry outreach efforts.

- Prepare literature for all Missouri-registered investment adviser firms to alert them of senior issues and provide them with the Missouri Securities Division's recommendations of best practices in dealing with senior customers.

- Investigate the possibility of adding a regulation requiring investment advisers to have policies and procedures in place regarding senior issues, or to otherwise be able to

demonstrate a careful, thorough plan for addressing the unique issues presented by senior clients.

- Work with consumer groups to inform all investors of the importance of understanding and researching the credentials of financial and securities professionals.

- Continue to work with fellow state regulators to protect senior investors through coordinated exams and shared investigative priorities.

- Identify and review opportunities for securing additional resources to expand and enhance the Missouri Securities Division senior investor protection efforts, including federal grants that could be employed to attract and maintain professionals and resources needed to investigate instances where seniors were provided unsuitable recommendations or exposed to fraud and to prevent the same through proactive examination and education of the regulated entities in the state.